STATE OF CALIFORNIA GRAY DAVIS, *Governor*

PUBLIC UTILITIES COMMISSION
505 VAN NESS AVENUE
SAN FRANCISCO, CA 94102-3298

May 6, 2003 **Agenda ID #2186**

TO: PARTIES OF RECORD IN APPLICATION 01-02-030

This is the draft decision of Administrative Law Judge McKenzie. It will not appear on the Commission's agenda for at least 30 days after the date it is mailed. The Commission may act then, or it may postpone action until later.

When the Commission acts on the draft decision, it may adopt all or part of it as written, amend or modify it, or set it aside and prepare its own decision. Only when the Commission acts does the decision become binding on the parties.

Parties to the proceeding may file comments on the draft decision as provided in Article 19 of the Commission's "Rules of Practice and Procedure." These rules are accessible on the Commission's website at http://www.cpuc.ca.gov. Pursuant to Rule 77.3 opening comments shall not exceed 15 pages. Finally, comments must be served separately on the ALJ and the assigned Commissioner, and for that purpose I suggest hand delivery, overnight mail, or other expeditious method of service.

/s/ Angela K. Minkin
Angela K. Minkin, Chief
Administrative Law Judge

ANG: avs

Decision **DRAFT DECISION OF ALJ McKENZIE (Mailed 5/6/2003)**

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of Southern California Edison Company (U 338-E) For An Order Under Section 701 of the Public Utilities Code Granting Southern California Edison Company Authorization to Recover TRRRMA Costs.	Application 01-02-030 (Filed February 28, 2001)

DECISION DENYING APPLICATION TO RECOVER COSTS BOOKED IN THE TRANSMISSION REVENUE REQUIREMENT RECLASSIFICATION MEMORANDUM ACCOUNT

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DECISION DENYING APPLICATION TO RECOVER COSTS BOOKED IN THE TRANSMISSION REVENUE REQUIREMENT RECLASSIFICATION MEMORANDUM ACCOUNT

Summary

In this application, Southern California Edison Company (Edison or SCE) asks for authority to recover, as a debit to its Transition Cost Balancing Account (TCBA), costs that have been tracked since 1998 in the Transmission Revenue Requirement Reclassification Memorandum Account (TRRRMA), which was established by Resolution E-3544. Edison also seeks authority to recover on an ongoing basis the costs that are booked annually in TRRRMA, which amount to about $24 million, in the distribution rates that are currently in effect for Edison.

As explained below, TRRRMA was created because of the need, as a result of electric restructuring, for the Federal Energy Regulatory Commission (FERC) to set electric transmission rates, while jurisdiction over retail distribution rates remained with this Commission. For the purpose of setting transmission rates, FERC was called upon to allocate to the transmission function, a suitable portion of the nongeneration revenue requirement derived from the decision in Edison's 1995 Test Year General Rate Case (GRC), Decision (D.) 96-01-011.

In D.97-08-056 (74 CPUC2d 1), the so-called "unbundling" decision, the Commission adopted Edison's proposal to allocate $211 million of the revenue requirement derived from the 1995 GRC to transmission. We also concluded that $1.668 billion of the 1995 GRC revenue requirement should be allocated to distribution. *See*, 74 CPUC2d at 43, 58 (Appendix B, Table 1.) We cautioned, however, that these were not final allocations, because FERC would make its own independent assessment of the proper revenue requirement for transmission, and Edison would be expected to prove in later proceedings that

all of the claimed $1.668 billion was properly allocable to distribution. (74 CPUC2d at 19.)

FERC issued its decision on Edison's retail transmission rates in 2000. Opinion 445, 92 FERC ¶61,070, issued July 26, 2000 (Opinion 445). In that opinion, FERC rejected Edison's proposed allocation of certain Administrative and General (A&G) and General and Intangible plant (G&I) expenses to the retail transmission function, based on the conclusion that FERC's traditional labor cost ratio method of allocation was superior to the "multi-factor" allocation methodology proposed by Edison.[1] Under the terms of Resolution E-3544, the total of A&G and G&I expenses found ineligible for inclusion in transmission rates by FERC (*i.e.*, $24 million annually), could be booked in TRRRMA.[2]

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[1] FERC described the multi-factor allocation methodology (which this Commission had approved in D.97-08-056) as follows:

> "A&G and G&I costs would be assigned to generation, ISO transmission, and non-ISO business segments by grouping these costs into one of three cost attribution pools: direct, joint, or common. These costs would then be assigned to the appropriate business segment based on the attribution technique specific to that pool, with the stated objective of limiting the amounts to which general allocation formulas are applied." (92 FERC at p. 61,267.)

For D.97-08-056's similar description of the multi-factor allocation methodology, *see* 74 CPUC2d at 17.

[2] Edison's application describes the components of the $24 million as follows:

> "A&G expenses including franchise fees account for nearly $6.1 million of the $24.0 million difference in revenue requirements resulting from the use of the labor allocator approach as compared with the Commission-adopted cost separation methodology. The remaining $18 million relates to the lower G&I plant costs allocable to ISO transmission under FERC's labor allocator approach." (Application, p. 24.)

As stated in Resolution E-3544, the purpose of TRRRMA is "to provide *the opportunity* for the utilities to make a showing that the costs which are deemed non-transmission related by FERC may be reasonable distribution costs." (Finding No. 7; emphasis added.) In this application, Edison asks, in effect, that it be excused from making such a showing, based on the argument that if the A&G and G&I costs at issue are not transmission-related, they are *ipso facto* distribution-related. Because we rejected this argument in D.97-08-056, and for the other reasons set forth below, we decline to excuse Edison from meeting the burden of proof that was clearly established for the recovery of TRRRMA costs in Resolution E-3544. However, as noted in the application, Edison still has an opportunity to pursue recovery of these costs through the Conditional Request for Rehearing of Opinion 445 that it has filed at FERC.

Background

Until this Commission began to implement electric restructuring in the mid-1990s, there was no need to allocate Edison's total revenue requirement among generation, transmission, distribution and other functions. Instead, the Commission's practice in GRCs was to adopt an overall revenue requirement for the utility for a particular "test year," and then in a later phase of the GRC, to allocate this revenue requirement among customer classes and design rates to recover these allocations.

It was this traditional approach that was followed in Edison's 1995 GRC, which the Commission predicted would be the last such proceeding before the implementation of electric restructuring. In D.96-01-011, the so-called "Phase I" decision in Edison's 1995 GRC, the Commission – after rejecting a stipulation offered by Edison and other parties, and after making an independent assessment of the hearing record – adopted an overall revenue requirement, or

Authorized Level of Base Rate Revenue (ALBRR), of $4.017 billion for Edison. (*See* 64 CPUC2d at 397.)

The need to allocate the ALBBR among the utility's various functions – as electric restructuring required – was first dealt with in D.96-09-092 (68 CPUC2d 275). In that decision, the Commission adopted a performance-based ratemaking (PBR) mechanism for the nongeneration revenue requirement derived from Edison's 1995 GRC (*i.e.*, transmission and distribution), as well as a distribution–only PBR mechanism that would go into effect once FERC and this Commission had adopted a separation between transmission and distribution of Edison's rate base and its base rate revenue requirement. After making various adjustments to Edison's proposal for separating the ALBRR between generation and nongeneration, we directed Edison to file a compliance advice letter incorporating these adjustments. (68 CPUC2d at 291-292.) Pursuant to that advice letter (1191-E-A), Edison's nongeneration revenue requirement for 1997 was set at $1.902 billion. For purposes of the "unbundling" proceeding described below, Edison developed a 1996 nongeneration PBR starting point of $2.028 billion.

The implementation of electric restructuring required that there be a further allocation of the nongeneration revenue requirement among transmission, distribution, and other functions. The Commission tackled this task in D.97-08-056, the unbundling decision. In that case, Edison proposed that from its 1996 nongeneration revenue requirement, $211 million be allocated to transmission, $1.816 billion to distribution, and $282 million to nuclear decommissioning and public purpose programs. In its application, Edison made the following suggestion for determining the distribution revenue requirement:

> "Edison recommends that the Commission derive its distribution rates by subtracting FERC-adopted transmission rates from the amount identified in its PBR as nongeneration rates. Edison refers to this residual approach as a 'rate credit' method. Edison supports this approach by observing that the Commission has already approved Edison's nongeneration revenue requirement and that FERC is expected to rule soon on the utilities' transmission revenue requirement proposals." (74 CPUC2d at 17.)

Although D.97-08-056 adopted Edison's proposal to allocate $211 million of the nongeneration revenue requirement to transmission, it specifically rejected Edison's proposal that the revenue requirement and rates for distribution be set using the "residual" approach. The Commission gave two related reasons for this rejection. First, to do so would be to "abandon our own authority or responsibility to FERC by allowing it to determine the revenue requirement for distribution, a determination over which we have sole responsibility and authority." (*Id.* at 18.) Second, adopting the residual approach

> ". . . could put us in the position of second-guessing FERC decisions. To the extent that FERC reduces the utilities' proposed revenue requirements, it finds that for whatever reason the costs of utility transmission are not reasonable. The utilities propose that we effectively overlook the FERC's findings and . . . determine that those same costs are reasonable by including them in distribution rates. We would only grant such a request with a showing that the specific costs are both reasonable and associated with distribution activities. None of the utilities have made such a showing here[,] if for no other reason than they have no FERC decision upon which to form their proposals." (*Id.* at 19.)

Resolution E-3544 and the Creation of TRRRMA

Consistent with its position in the unbundling case, Edison in late 1997 submitted a Transmission Owner (TO) rate proposal to FERC based on the

$211 million revenue requirement adopted in D.97-08-056. FERC accepted the TO tariff for filing on December 17, 1997. FERC's order accepting the filing provided that the rates would become effective, subject to refund, on the date the California ISO began operation, which turned out to be April 1, 1998.[3]

Apparently anticipating that FERC might not find all of the $211 million revenue requirement to be reasonably related to transmission, Edison also filed an advice letter (No. 1298-E) with this Commission on March 28, 1998. The advice letter asked that the TRRRMA be established "to track the revenue requirements associated with those costs requested by Edison for recovery in transmission rates in Docket No. ER97-2355-000 which the FERC may, at a later date, not allow to be included in the transmission rates." In its advice letter, Edison argued that establishing a TRRRMA was consistent with D.97-08-056, and that the amounts tracked in the account would be considered in a future Commission proceeding to determine the appropriateness of including them in distribution rates. San Diego Gas and Electric Company (SDG&E) filed a similar advice letter (No. 1088-E).

On July 23, 1998, in Resolution E-3544, the Commission granted Edison and SDG&E permission to establish the TRRRMA. However, the resolution was careful to note that by allowing this new memorandum account, the Commission was not authorizing the automatic recovery in distribution rates of amounts that FERC might not include in transmission rates on the ground they were not transmission-related:

> "As both Edison and SDG&E have correctly noted in their responses to ORA's protests, the mere establishment of

[3] Application, p. 19.

> these accounts do[es] not guarantee recovery of the costs. A TRRRMA would only set up a mechanism for the utilities to track certain costs that are disallowed by FERC. Amounts booked into these accounts will be considered in future proceedings, where the Commission will have an opportunity to review their appropriateness for recovery, as well as address relevant ratemaking issues. Therefore, the sole purpose of the TRRRMA would be to track certain costs that are disallowed by FERC without any determination of their recovery. This approach is consistent with D.97-08-056.[4] We agree with Edison that because utilities are currently incurring these costs, denying the establishment of a TRRRMA would put them at risk for recovery of these costs and could deny them the opportunity to recover, in future proceedings, costs that are distribution-related and reasonable." (Resolution E-3544, pp. 3-4.)

In addition to noting that the recovery of TRRRMA costs would be contingent upon appropriate showings in future proceedings, Resolution E-3544 also stated that (1) only costs eligible for recovery in Edison's PBR could be tracked in TRRRMA, and (2) Edison would be required to treat as a reduction to the TRRRMA balance, any costs that Edison had characterized as distribution-related but that FERC subsequently determined were transmission costs includable in transmission rates.

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4 This is apparently a reference to the following passage from D.97-08-056 discussing whether distribution rates should be set residually:

> "The utilities propose that we effectively overlook the FERC's findings [that some costs are not transmission costs] and . . . determine that those same costs are reasonable by including them in distribution rates. *We would only grant such a request with a showing that the specific costs are both reasonable and associated with distribution activities.*" (74 CPUC2d at 19; emphasis added.)

Edison's Transmission Rate Proceeding at FERC

The disallowance of some costs that Edison had characterized as transmission-related did indeed occur in the FERC proceedings. In his Initial Decision in Docket Nos. ER97-2355-000, *et al.*, issued on March 31, 1999, the FERC ALJ ruled that Edison had not demonstrated that its multi-factor methodology for allocating A&G and G&I costs was superior to FERC's traditional labor ratio allocation method, and therefore Edison's method should be rejected. After noting that Edison's proposed allocations under the multi-factor approach were not adequately supported by its accounting data, the FERC ALJ said:

> "SCE's proposal does not sufficiently establish that its method is more reliable than the allocation of costs by labor ratios. SCE has failed to demonstrate that the California restructuring situation has changed the nature of G&I or A&G costs and any allocation of such costs. The goal remains to assign the proper amount of costs to each function, *i.e.*, transmission services. The timing of rate cases before this Commission, and also before the CPUC, has at times caused an amount of uncertainty regarding the assignment of G&I or A&G costs for recovery in regulated rates. But that fact alone does not provide a valid reason to now abandon the labor ratio method long endorsed by this Commission for many years. Thus, it is found that SCE has not demonstrated that the labor ratio method is unjust and unreasonable and that its proposed methodology is just and reasonable."[5]

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[5] *Southern California Edison Company*, Dockets Nos. ER97-2355-000, *et al.*, Presiding Administrative Law Judge (ALJ's) Initial Decision (issued March 31, 1999), 86 FERC ¶63,014 at p. 65,145. This decision is hereinafter referred to as the "FERC ALJ's Initial Decision."

Edison appealed from this and several other determinations in the FERC ALJ's Initial Decision. However, in Opinion 445, FERC affirmed the Initial Decision's determination on the labor ratio cost methodology in strong terms. Noting that this Commission had provided an opportunity to recover the TRRRMA costs in Resolution E-3544, FERC said:

> "We will affirm the Initial Decision. The majority of the arguments raised by SoCal Edison on exceptions were presented at hearing and were properly disposed of in the Initial Decision. We also find that the Presiding Judge properly applied the Commission's existing policy for allocating A&G and G&I costs. In addition, the California Commission has made clear in its comments that SoCal Edison has the opportunity, if it so chooses, to seek state jurisdictional review and potential recovery of any non-transmission costs subject to the California Commission's jurisdiction. Given this opportunity, we find that SoCal Edison's claimed inability to recover its legitimately incurred costs, due to changes in jurisdiction, is unfounded." (92 FERC at p. 61,268.)

Edison has not accepted Opinion 445 as the final word on this matter. On August 25, 2000, Edison filed with FERC what it termed a Conditional Request for Rehearing of Opinion 445. After noting the suggestion in the passage above that Edison should seek recovery of the A&G and G&I costs at issue from the CPUC, the conditional rehearing request states:

> "SCE intends to make a filing with the CPUC shortly to recover these costs. If the CPUC denies that request, however, SCE will be in the position where both agencies will have suggested the other agency as the proper forum for cost recovery, with SCE unable to recover the costs from either agency. SCE respectfully requests, therefore, that if the CPUC denies SCE's request, the Commission allow SCE to recover these costs through its FERC-jurisdictional rates. Any result short of this will

> result in SCE losing over $20 million/year solely due to changes in jurisdiction -- precisely the result the Commission sought to avoid in its Opinion. Moreover, this result would be inconsistent with the Commission's policy set forth in Order No. 2000 that a utility will not be penalized for turning over its transmission facilities from state to federal jurisdiction." (Conditional Request for Rehearing, pp. 2-3.)

In addition to these policy arguments, Edison's Conditional Request for Rehearing also maintains that Opinion 445 committed legal error by requiring Edison to prove that its multi-factor allocation methodology was superior to the traditional labor cost allocation methodology. On this issue, the conditional rehearing request states:

> "The Presiding Judge rejected SCE's proposal because SCE failed to show that the use of labor ratios was unjust and unreasonable, citing the Commission's policy established in *Minnesota Power & Light Co.*, 5 FERC ¶61,091 (1978) . . . The Commission affirmed the Presiding Judge on this issue . . . The Commission's imposition of this obligation on SCE is erroneous, however, because it impermissibly applies the burden of proof that applies to the Commission under Federal Power Act (FPA) Section 206 to a Section 205 proceeding. The courts have carefully distinguished between the burden of proof provisions in FPA Sections 205 and 206 . . . In a Section 205 proceeding, a utility need only show that its proposal is just and reasonable; it does not have to show that another method is unjust and unreasonable, or that its proposal is more accurate or reliable than another method." (*Id.* at 5, n. 6 (citations omitted)).

Edison's Application

In its February 2001 application in this matter, Edison asked for two forms of relief. First, as noted above, it asked that the balance recorded in the TRRRMA account be transferred as a debit to the TCBA revenue account. Second, Edison

requested that it be allowed to collect the $24 million recorded annually in TRRRMA in the PBR distribution rates authorized in D.96-09-092. The authorization to collect this $24 million would continue until Edison's next GRC.

After setting forth the complex history summarized above, Edison's application argues in strong terms that the requested relief should be granted because "the Commission's representations in the FERC case demonstrated that the Commission intended to allow for recovery of [TRRRMA] costs." (Application, p. 11.) Edison contends that in addition to approving the multi-factor allocation methodology in D.97-08-056, the Commission's conduct during the FERC proceedings shows a clear intent to allow recovery of the TRRRMA balances in distribution rates:

> "The Commission's position at FERC of: a) agreeing that the overhead allocation methodology presented to FERC is the same method that the Commission approved; and b) indicating to FERC that SCE has another avenue for recovery (*i.e.*, TRRRMA) of these costs in the event FERC rejects SCE's and the Commission's cost allocation methodology, *strongly suggests* that the Commission intended to treat these costs as distribution-related and provide for TRRRMA recovery in the event FERC adopted a labor allocation methodology. *Precluding SCE from recovery of costs recorded in the TRRRMA would be entirely inconsistent with the position taken by the Commission in the FERC proceeding.*" (*Id.* at 12-13; emphasis added.)

In addition to arguing that this Commission has essentially promised recovery of the TRRRMA balances in distribution rates, the application sets forth a detailed description of how Edison proposes to do this. A key point is that the A&G and G&I amounts Edison claims it should recover under TRRRMA would "net out" the refunds owed to transmission customers because of FERC's

reduction of the $211 million revenue requirement that Edison had requested in Docket No. ER97-2355-000 *et al*.:

> "In this application, SCE is proposing TCBA treatment for both the TRRRMA balance (as a debit to the Revenue Account of the TCBA) and transmission revenue-related refunds (as a credit to the Revenue Account of the TCBA). This ratemaking treatment will result in a net credit to the TCBA by the amount related to the various updates, stipulations and FERC orders discussed in previous sections of this Application (*i.e.*, approximately $14 million in annual revenue requirement). The remaining amount of the transmission revenue-related refunds will effectively net out the balance in the TRRRMA." (*Id.* at 27.)[6]

The application concludes with a plea that the requested relief be granted *ex parte*, because Edison "has attached to this application, or incorporated by reference, all of the data needed to support this application." (*Id.* at 6, 34.)

ORA's Protest

Despite Edison's request for *ex parte* relief, the Office of Ratepayer Advocates (ORA) filed a protest of April 5, 2001. In addition to the background above, the protest set forth two principal reasons for opposing the application. First, ORA contended, agreeing to treat the costs booked in TRRRMA as

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[6] In a footnote to the application, Edison quantifies the amounts to be netted against each other as follows:

> ". . . SCE's transmission revenue requirement request, reflected in [FERC] rates subject to refund on April 1, 1998, of $211 million, was lowered to $173 million, for an annualized revenue requirement difference of $38 million. SCE's requested TRRRMA cost recovery is based on an annualized revenue requirement of $24 million, for a net annualized credit of $14 million to the TCBA. (Note that this analysis ignores the impact of sales growth on the $38 million annualized transmission revenue requirement refund and interest.)" (*Id.* at 28, n. 39.)

distribution-related would amount to blessing FERC's labor ratio cost allocation methodology, despite the Commission's specific approval of the multi-factor allocation methodology in D.97-08-056. Noting that "the appropriate portion of SCE's revenue requirement has already been properly allocated to distribution" by the Commission, ORA concluded that "the outcomes of FERC proceedings [should] not dictate the ratemaking treatment to be applied by this Commission." (ORA Protest, pp. 3-4.)

Second, ORA vigorously disputed Edison's suggestion that FERC had relied on representations by the CPUC that if the A&G and G&I costs at issue were not included in transmission rates," these costs could be recovered in Commission-jurisdictional rates if rejected by FERC." ORA insisted that no such representations had been made, as evidenced by the careful description of the limitations on TRRRMA set forth in CPUC comments filed in the FERC transmission proceeding:

> "Edison's allegation that this purported $20 million would be unrecoverable and would fall through the jurisdictional cracks is misleading. Edison filed an advice letter with the CPUC proposing a memorandum account to recover FERC-disallowed costs, and on July 23, 1998, the CPUC issued a resolution approving the memorandum account for any costs which the FERC found were not transmission-related costs in the rate case. *See* Ex. AWP-6. Thus, if Edison is able to subsequently demonstrate that these costs are reasonable, distribution-related costs (as opposed to generation-related costs), Edison can recover these costs in distribution rates." (Reply Comments of the Public Utilities Commission of the State of California, Docket No. ER97-2355-000, et al., filed November 30, 1999, p. 19, *quoted in* ORA Protest, p. 5.)

The July 18, 2001 Prehearing Conference and Submission of the Case Without Hearings

A prehearing conference (PHC) was held in this matter on July 18, 2001. After answering some questions by the assigned ALJ, Edison's counsel insisted once again that hearings were unnecessary, and that testimony by Edison personnel would add little to what was already in the application. (PHC Transcript, pp. 9, 14-15.) ORA's counsel, on the other hand, felt that testimony was necessary to demonstrate, among other things, the rate impacts of allowing TRRRMA balances to be recovered in distribution rates. (*Id.* at 15.) After further discussion, the parties agreed that ORA would serve direct testimony on September 7, 2001, and that based on Edison's review of this testimony, it would advise ORA and the ALJ whether it considered rebuttal testimony or a hearing to be necessary. (*Id.* at 23-24.)

In addition to the arguments in its protest, ORA's testimony set forth four additional reasons why Edison should not be allowed to recover the TRRRMA costs in distribution rates. First, ORA emphasized that the multi-factor allocation methodology was developed jointly by Edison and ORA in workshops, and that Edison's witnesses testified at FERC strongly in support of the multi-factor approach. Thus, ORA concluded, Edison has "a significant degree of ownership of this methodology," and should not now be heard to urge a *de facto* abandonment of it. (ORA Testimony, pp. 6-9.)

Second, ORA argued that Resolution E-3544 imposes a clear burden of proof on Edison before it may recover the TRRRMA balances in rates, and Edison has failed to meet that burden. Edison's counsel effectively admitted the company could not prove the amounts booked in TRRRMA are distribution-related, ORA contended, and the company had also failed to offer any proof that FERC's labor ratio allocation methodology is superior to the

multi-factor approach, proof without which the CPUC should not abandon the multi-factor methodology. (*Id.* at 10-11, 13-16.)

Third, relying upon a statement made by Edison's counsel during the PHC, ORA argued that the filing of this application really constitutes an attempt by Edison to exhaust its administrative remedies at the CPUC before returning to FERC to pursue seriously the Conditional Request for Rehearing of Opinion 445. (*Id.* at 17-18.)

Finally, ORA pointed out that if Edison's application were to be granted, the Domestic rate group (*i.e.*, residential customers) would pay about $870,000 more of the distribution revenue requirement, while the Large Power rate group (*i.e.*, large commercial and industrial customers) would pay approximately $1.53 million less. (*Id.* at 19.)

After reviewing ORA's testimony, Edison advised the ALJ and ORA that it saw no need either for rebuttal testimony or hearings, and that the matter could be submitted on briefs. Pursuant to a ruling by the ALJ, Edison and ORA submitted concurrent briefs on September 28, 2001.

ORA's brief merely summarizes the points made at greater length in its testimony. Edison's brief relies principally on the application, but also addresses specifically a few of the points in the ORA testimony. First, Edison reiterates that it is not urging this Commission to cede its authority over distribution rates to FERC, as ORA contends. Rather, Edison states:

> "Authorizing recovery of the TRRRMA costs is not based on a FERC proceeding alone. The Commission authorized the total revenue requirement in the first place and classified the costs that have been recorded in the TRRRMA as nongeneration. Just as important, this Commission did *not* unbundle the nongeneration revenue requirement into distribution and transmission components. Instead, the Commission

> arithmetically subtracted the *proposed* transmission revenue requirement from the total nongeneration revenue requirement authorized by the Commission. Thus, authorizing recovery of the amounts in the TRRRMA would not contradict previous Commission determinations, but would be consistent with them." (Edison Brief, p. 4; footnote omitted, emphasis in original.)

Second, Edison argues that ORA is "disingenuous" in arguing that Edison should be given an opportunity to return to FERC to prove that the costs booked in TRRRMA are transmission-related, because in Opinion 445, "FERC relied on the statements made by this Commission . . . which suggested that the recovery of the TRRRMA costs would not be denied simply because of different allocation methodologies used by the two regulatory authorities." (*Id.* at 5.)

Finally, Edison argues that the Commission should give little weight to ORA's concern about domestic customers having to pay more of the distribution revenue requirement if the application is granted, because the increase would amount to less than two cents per month for a typical residential customer, and is thus *de minimis.* (*Id.* at 6-7.)

Discussion

Although we think that both Edison and ORA have cast each other's positions in the most extreme light, we must agree with ORA that Edison has failed to meet the burden of proof established in Resolution E-3544 for recovering TRRRMA costs in distribution rates. In essence, Edison is making the same argument for setting distribution rates "residually" that it made in 1997, an argument we rejected in D.97-08-056. (*See* 74 CPUC2d at 19.) We continue to think that before allowing recovery of the A&G and G&I costs booked in TRRRMA, Edison should be required to offer some proof that these costs are reasonable and distribution-related.

Even though Edison disclaims such an intention, it seems clear that in this application, Edison is asking as a practical matter to be relieved of the results of its agreement to use the multi-factor allocation methodology. Apart from the fact that we accepted this methodology in D.97-08-056, we are unwilling to undercut it by granting the relief Edison has requested because the multi-factor methodology is the product of a settlement between Edison and ORA. As Edison's counsel explained at the PHC, ORA had criticized Edison's use of the labor ratio allocation methodology in its first nongeneration PBR application, A.93-12-029. In response to this criticism, the multi-factor approach was jointly devised by Edison and ORA in workshops under the auspices of the Ratesetting Working Group. (PHC Tr., pp. 9-10; Edison Brief, pp. 5-6.)

While we know the nature of the new allocation methodology that resulted from these workshops, we do not know what other consideration Edison received in exchange for its agreement to use the multi-factor approach in its filings. Under these circumstances, we are reluctant to grant relief that would, as a practical matter, render the multi-factor methodology a dead letter.

In addition to our reluctance to undercut a methodology that is the product of a settlement, we are troubled by the fact that Edison has not attempted to offer any proof that the TRRRMA costs it is seeking to recover are either reasonable or distribution-related. Instead of offering such proof, Edison has merely (1) repackaged the residual approach, and (2) insisted that representations made by our staff during the transmission rate proceeding caused FERC to reject the multi-factor methodology, because FERC believed the TRRRMA costs would be recovered here at the Commission. In our view, neither of these arguments has merit.

Edison's continued reliance on the residual approach is apparent from the following passage in its reply to ORA's protest:

> "In [D.97-08-056] the Commission found reasonable and adopted a nongeneration revenue requirement, based on 1995 GRC authorized A&G and G&I plant costs, a portion of which is now recorded in the TRRRMA. FERC adopted a transmission revenue requirement that did not include the TRRRMA costs based solely on the use of a different allocation methodology. Logically, (1) the TRRRMA costs have been determined by the Commission to be reasonable nongeneration costs, (2) the FERC found them not to be transmission related and neither the CPUC [n]or FERC disallowed the costs from recovery,[7] therefore, by definition, (3) they are distribution-related costs." (Reply to Protest, p. 4.)

There are several flaws with the conclusion in this syllogism. First, although it is true that D.97-08-056 concluded it was reasonable to treat the A&G and G&I costs in question as nongeneration costs, the decision emphasized that it was adopting these costs as an interim measure, and that the Commission expected further proof would be offered in the event FERC refused to include some of the claimed transmission costs in transmission rates:

> "Just as we have declined to reduce the distribution revenue requirements in this proceeding to account for costs associated with activities the utilities may no longer conduct,[8] we

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[7] Edison repeatedly notes in its papers, and ORA does not disagree, that while FERC declined to include the TRRRMA costs in transmission rates, neither FERC nor this Commission has "disallowed" these costs; *i.e.*, found that they are unreasonable.

[8] At an earlier point in D.97-08-056, the Commission expressly declined to act on proposals to modify the most recently-adopted revenue requirements for Edison and the other utilities "to reflect activities that the utilities will no longer undertake following the implementation of direct access." On this question, D.97-08-056 stated:

> "This proceeding is not the appropriate forum for reaching the potentially complex issues relating to changes in revenue requirements. In

Footnote continued on next page

> decline to increase the distribution revenue requirements to account for [adverse] FERC decisions. In each instance, the utilities will have an opportunity to make their case with regard to specific revenue requirements changes in their PBR proceedings, or, for PG&E, general rate case. In the interim, we will adopt the revenue requirement for distribution that each utility proposes here with the adjustments we make in subsequent sections, consistent with law and policy. To the extent necessary, we will revisit these revenue requirements at a later date . . ." (74 CPUC2d at 19.)

The second flaw in Edison's syllogism is the proposition that it is reasonable to treat as distribution-related, all costs that FERC declined to include in transmission rates. The Commission clearly rejected this argument in D.97-08-056, noting that "one of our criteria for determining the reasonableness of a proposal is whether it allocates the costs of a given function to that function's revenue requirement." (*Id.*) The Commission took this position largely because of concerns that since distribution is a monopoly function, the utilities would be tempted during the unbundling process to allocate excessive costs to that function:

> "In pursuing a policy to promote more efficient generation markets, we reject proposals to allocate to monopoly functions any costs associated with services that are or will be subject to competition. Specifically, we will not permit allocations of generation cost to distribution customers. To do so would

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> D.96-10-074, we ordered the utilities to file revenue requirements 'based on our *last authorization* and separate this total between transmission and distribution' . . . By this, we stated our intent to consider existing revenue requirements in this proceeding. We have accordingly emphasized allocations of existing costs to utility functions in this proceeding[,] rather than seeking to accomplish the more ambitious task of reviewing revenue requirements." (74 CPUC2d at 15; emphasis in original.)

> compromise market efficiency by producing artificially low utility generation rates . . . and provide competitive advantages, which would stifle competition to the utilities. Moreover, any allocation to monopoly customers of costs associated with competitive products would be unfair to monopoly customers because they would, in effect, be required to subsidize shareholder profits." (*Id.* at 15.)

In addition to disagreeing with the proposition that all costs booked in TRRRMA should automatically be considered distribution costs, we disagree with Edison's assertion that the Commission staff effectively promised FERC that any costs excluded from transmission rates due to FERC's use of the labor ratio allocation methodology would be recovered by Edison in the distribution rates subject to our jurisdiction. Although Edison doubtless wishes that our staff had made such promises, it is clear from an examination of the November 30, 1999 reply comments in FERC Docket No. ER97-2355-000 that no such representation was made. After describing the circumstances leading to the authorization of TRRRMA, staff's comments concluded that "*if Edison is able to subsequently demonstrate* that these costs are reasonable, distribution-related costs (as opposed to generation-related costs), Edison can recover these costs in distribution rates." (Emphasis added.) This statement stops well short of an unqualified promise.

We also think that changes in the California electric industry brought about by restructuring -- changes that were only beginning to take place when D.97-08-056 was decided -- make it reasonable to continue to hold Edison to the burden of proof for TRRRMA cost recovery set forth in Resolution E-3544. D.97-08-056 itself contemplated that the changes caused by restructuring would make it appropriate to reexamine utility revenue requirements:

> "We are aware that the utilities' activities will change in the next few years. For example, the ISO will take on dispatch and management of electric loads. The utilities may eliminate

> or redefine some of their customer relations and generation activities. Even if we do not create new forums to consider these potential cost reductions, we recognize that these types of changes in activities will affect utility revenue requirements in the near future. We find nothing in AB 1890 to restrict this Commission's authority to adjust revenue requirements as long as the changes are otherwise consistent with the statute's provisions." (74 CPUC2d at 15.)

In fact, in both Edison's transmission proceeding at FERC and in PBR filings at this Commission, some reexamination of Edison's nongeneration revenue requirement has taken place. A noteworthy example of this occurred in the FERC ALJ's Initial Decision in ER97-2355-000. In that case, our staff had challenged Edison's decision to compute A&G expenses for the period beginning January 1, 1998 (the so-called "Phase II" period) by escalating 1995 data. The FERC ALJ agreed that because of restructuring developments, Edison should be required to recompute its A&G expenses based on actual 1997 data:

> "As CPUC asserts, the fundamental purpose of this proceeding is to determine just and reasonable rates, particularly, in this proceeding where SCE has drastically restructured and downsized its previous utility operations and has turned over its transmission facilities to ISO control. Clearly the 1997 recorded A&G amounts, with the adjustment for divested generating plants, will more likely yield just and reasonable rates than SCE's poorly founded projections. Accordingly, SCE's projected 1998 A&G expenses are found to be unjust and unreasonable. SCE will, therefore, be directed to file a compliance filing substituting its 1997 actual data for A&G expenses for Period II, with the appropriate adjustment for divested generating plants." (86 FERC at pp. 65,176-77.)

The annual data that Edison has reported on its FERC Form 1, as well as Commission resolutions concerning the awards Edison has requested under its PBR mechanism, also suggest that since electric restructuring went into effect, Edison has experienced considerable volatility with respect to its distribution

expenses. For example, Table A-1 to Resolution E-3772 (which deals with Edison's request for a PBR award for calendar year 2000) shows Edison's PBR results-of-operation for 1997 through 2000. For the operation and maintenance expense data for distribution shown in Table A-1 (which are set forth below), the figure for 2000 is 62% higher than the one for 1997, and although the amounts increase with the passage of time, they do not reflect a simple trend from year-to-year:

1997	$172,299,000
1998	$277,127,000
1999	$243,964,000
2000	$278,065,000[9]

Although the data is not directly comparable, a similar (although smaller) variability can be seen in the operation and maintenance expense data for distribution that Edison reported to FERC on its Form 1 for the years 1996 to 2000, data of which we take official notice:

1996	$ 161,688,000[10]
1997	$ 177,924,000
1998	$ 203,754,000
1999	$ 179,611,000
2000	$ 201,689,000

[9] Table A-1 in Resolution E-3772 notes, however, that the year-to-year data it shows is not directly comparable, due to such things as the fact that in 1998, financial information through March 31st reflected nongeneration expense, while the data for the rest of the year reflected distribution-only expense.

[10] 1996 distribution expense data is not available for Edison's PBR mechanism, because that mechanism did not go into effect until January 1, 1997. *See* 68 CPUC2d at 309.

In view of the significant effect that electric restructuring has apparently had on Edison's distribution expenses, and the variability these expenses have shown since restructuring took effect, it is not unreasonable to require that before Edison is allowed to recover the TRRRMA balances in rates, it should offer some proof that the costs making up these balances are both reasonable and distribution-related.[11] However, Edison has elected not to offer any such proof, relying instead upon the syllogism quoted above.

We recognize that it will probably not be easy for Edison to offer the proof required by today's decision. As Edison's counsel stated at the PHC, "I don't have a witness to put on the stand who can point to a particular dollar in this $24 million a year and say, '[t]hat's definitely a distribution dollar.'" (PHC Tr., p. 9.)[12] We also recognize that the task of offering proof has been made

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[11] We also note that in the resolutions approving Edison's requests for PBR awards for 1998, 1999, and 2000, we have required Edison to submit proof in its 2003 GRC that distribution-related transmission expenses Edison claims should be subject to the PBR are in fact reasonable and distribution-related. *See*, Resolution E-3712, *mimeo.* at pp. 9-10; Resolution E-3771, *mimeo.* at pp. 10-11; Resolution E-3772, *mimeo.* at pp. 10-11.

[12] Later during the PHC, Edison's counsel elaborated upon the difficulties of proof he saw in this case:

> "[W]e were using a methodology here [*i.e.*, the multi-factor methodology] that had several steps to it . . . some parts of it you're looking directly at certain costs and you're assigning them . . .
>
> "But for the most part, there comes a point where you're using a methodology that doesn't enable you to look at a particular dollar and put somebody on the stand and say, 'Yep, that was in my business unit and I spent that dollar, and next year I'll need it and I'll spend it again next year.'
>
> "So we are at this position where we don't have a witness to take the stand to talk specifically to those costs." (PHC Tr., p. 14.)

more difficult by the apparent gaps in Edison's accounting data.[13] However, the burden of proof that Resolution E-3544 places upon Edison is clear, and it was obviously derived from the discussion in D.97-08-056. Under these circumstances, Edison cannot claim that the standard of proof it must meet in order to recover TRRRMA balances is, in ORA's words, "an unpleasant surprise." (ORA Testimony, p. 16.)

We close by noting that although Edison appears disinclined to offer this Commission the proof that Resolution E-3544 requires, Edison is not without some recourse. As noted above, the utility has filed at FERC a Conditional Request for Rehearing of Opinion 445, which sets forth both legal and policy arguments why FERC should reconsider its decision to affirm the ALJ's rejection of the multi-factor allocation methodology. At the PHC, Edison's counsel clearly stated that if this application were to be denied, Edison would be returning to FERC to pursue this alternative remedy. (PHC Tr., pp. 7-8.)

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[13] Deficiencies in Edison's accounting data were one of the reasons given by the FERC ALJ in his Initial Decision for rejecting the multi-factor allocation methodology:

> "SCE has clearly not shown that its method provides a more accurate result. As demonstrated by Staff and CPUC, SCE's detailed analysis of costs is lacking. The records produced lacked function codes (information on the activity performed) or location codes (geographic information). While SCE made certain judgments in formulating these assignments, there is no evidence of how these assignments were made or why certain assignments were made. Direct assignments of A&G expenses were made without including any information as to the reasons for such assignments . . . Only two percent of the A&G expenses were allocated to the direct pool . . . indicating that there is insufficient data to make direct assignments." 86 FERC at p. 65,145 (citations omitted).

Comments on Draft Decision

The draft decision of the ALJ in this matter was mailed to the parties in accordance with Section 311(g)(1) of the Public Utilities Code and Rule 77.7 of the Rules of Practice and Procedure. Comments were filed on _____, and reply comments were filed on_____.

Assignment of Proceeding

Loretta M. Lynch is the Assigned Commissioner and A. Kirk McKenzie is the assigned Administrative Law Judge in this proceeding.

Findings of Fact

1. The restructuring of the electric industry that began in California in the mid-1990s made it necessary to allocate Edison's revenue requirement among generation, transmission, distribution, and other functions.

2. The first step in this allocation process occurred in D.96-09-092, in which the Commission adopted an interim PBR mechanism for Edison's transmission functions (which mechanism was to remain in effect until the transfer of transmission rate-setting responsibilities to FERC), as well as a PBR mechanism for Edison's distribution functions that was to remain in effect until 2001.

3. As part of D.96-09-092, the Commission adopted, with modifications, Edison's proposal for allocating the revenue requirement derived from its 1995 GRC between generation and nongeneration.

4. In D.97-08-056, the Commission made interim allocations of the nongeneration revenue requirement derived from the 1995 GRC among transmission, distribution, and other functions.

5. In D.97-08-056, the Commission adopted Edison's proposal to allocate $211 million of the nongeneration revenue requirement to transmission, while

recognizing that FERC would eventually make its own determination as to the amount of costs properly includable in Edison's transmission rates.

6. In D.97-08-056, the Commission determined the amount of Edison's nongeneration revenue requirement that should be allocated to distribution on an interim basis by subtracting the $211 million that Edison proposed to allocate to transmission, as well as $282 million that Edison proposed to allocate to nuclear decommissioning and public purpose programs.

7. In D.97-08-056, the Commission accepted Edison's proposal to allocate A&G costs among the various functions by using a multi-factor allocation methodology in which the first step is to determine whether the cost at issue is direct, joint or common.

8. In D.97-08-056, the Commission expressly declined to set distribution rates through the "residual" or "rate credit" method proposed by Edison; *i.e.*, by subtracting the revenue from FERC-approved transmission rates from the total nongeneration revenue requirement.

9. Rather than use the residual approach advocated by Edison, D.97-08-056 ruled that costs not included by FERC in transmission rates would be eligible for inclusion in distribution rates only upon a showing that these costs were both reasonable and distribution-related.

10. In late 1997, Edison submitted a transmission rate proposal to FERC based upon the $211 million allocated to transmission in D.97-08-056.

11. Edison's transmission rate proposal to FERC allocated A&G and G&I costs by using the multi-factor allocation methodology described in Finding of Fact (FOF) No. 7.

12. FERC's order accepting Edison's filing provided that the proposed transmission rates (a) would go into effect, subject to refund, on the date the California ISO began operation, and (b) would be the subject of hearings.

13. In Advice Letter 1298-E, Edison requested that the TRRRMA be established to track the revenue requirement associated with costs that Edison had requested be included in transmission rates, but which FERC might later find were not properly includable in transmission rates because they were not transmission-related. SDG&E filed an advice letter seeking similar relief.

14. In Resolution E-3544, the Commission authorized the establishment of TRRRMA. However, the resolution noted that by authorizing this new memorandum account, the Commission was not authorizing the automatic recovery in distribution rates of amounts that FERC declined to include in transmission rates on the ground they were not transmission-related. Rather, Resolution E-3544 stated that before Edison and SDG&E could recover such costs in distribution rates, they would be required to show that the costs were both reasonable and distribution-related.

15. In addition to the requirement set forth in the preceding FOF, Resolution E-3544 stated that (a) only costs eligible for recovery in the respective PBRs of Edison and SDG&E could be tracked in TRRRMA, and (b) Edison and SDG&E would be required to treat as a reduction to their TRRRMA balances, any costs that the utilities had characterized as distribution-related but that FERC subsequently determined were transmission-related, and thus includable in transmission rates.

16. In his Initial Decision in Docket No. ER97-2355-000, the FERC ALJ ruled that Edison had failed to demonstrate that the multi-factor allocation methodology described in FOF No. 7 was superior to FERC's traditional labor

cost ratio allocation methodology, or that the multi-factor methodology was just and reasonable.

17. Edison appealed the ALJ's determination on the multi-factor allocation methodology to FERC, but in Opinion 445, FERC affirmed the ALJ's determination for the reasons set forth in the Initial Decision.

18. In affirming the ALJ's Initial Decision, FERC noted that Edison would have an opportunity to recover in CPUC-determined distribution rates, the A&G and G&I costs not included in transmission rates as a result of using the labor ratio allocation methodology.

19. Edison has filed a Conditional Request for Rehearing of Opinion 445, in which it argues that FERC's decision to affirm the ALJ's determination with respect to the multi-factor allocation methodology is erroneous for both legal and policy reasons.

20. As a result of FERC's decision in Opinion 445 with respect to the allocation of A&G and G&I costs, approximately $24 million of such costs are eligible for inclusion annually in Edison's TRRRMA balance.

21. In addition to requesting that the balance in its TRRRMA account be transferred as a debit to its TCBA revenue account, Edison's application requests that it be authorized to collect in existing distribution rates, the $24 million annual amount described in the preceding FOF.

22. The argument in Edison's application and brief for treating as distribution costs, the A&G and G&I costs not included by FERC in transmission rates, is the same argument for setting distribution rates residually that the Commission rejected in D.97-08-056.

23. The burden of proof established in Resolution E-3544 for the recovery of TRRRMA costs in distribution rates is clear.

24. Edison waived its right to submit testimony on the issues raised by this application, and also took the position that hearings were unnecessary.

25. Apart from the argument described in FOF No. 22, Edison has offered no proof that the TRRRMA costs it is seeking to recover in this application are either reasonable or distribution-related.

26. Commission staff did not represent to FERC during the transmission proceeding in Docket No. ER97-2355-000 that A&G and G&I costs not included in transmission rates as a result of using the labor ratio allocation methodology would automatically be recoverable in distribution rates. Instead, the staff's comments stated that such costs would be eligible for recovery in distribution rates upon proof that the costs were both reasonable and distribution-related.

27. The FERC ALJ's Initial Decision in Docket No. ER97-2355-000 *et al.* concluded that because of electric restructuring developments, Edison should be required to use actual 1997 data to compute A&G expenses for the period beginning January 1, 1998, rather than relying upon escalated 1995 data.

28. The distribution expense data that Edison has reported to this Commission in advice letters seeking PBR awards for the years 1997-2000 reflects a high degree of variability rather than a clear year-to-year trend.

29. The distribution expense data that Edison has reported to FERC in its Form 1 filings since 1996 also reflects variability rather than a consistent year-to-year trend, although the variability is less than in Edison's PBR data.

30. Edison has stated that if this Commission denies its application to recover the TRRRMA balances in distribution rates, Edison intends to pursue the Conditional Request for Rehearing described in FOF No. 19.

Conclusions of Law

1. The testimony that ORA served on September 7, 2001, should be made part of the record in this proceeding.

2. We should take official notice of the operation and maintenance expense data for distribution that Edison has reported on its FERC Form 1 submissions since 1996.

3. Edison has not satisfied the burden of proof set forth in Resolution E-3544, which requires that before costs booked in TRRRMA can be recovered in distribution rates, the utility must prove that the costs are both reasonable and distribution-related.

4. Edison has not demonstrated that it should be relieved of the burden of proof described in the preceding Conclusion of Law.

5. The application in this proceeding should be denied.

O R D E R

IT IS ORDERED that:

1. The testimony of the Office of Ratepayer Advocates served in this proceeding on September 7, 2001, is hereby admitted into evidence as Exhibit 1.

2. The application of Southern California Edison Company in this proceeding is denied.

This order is effective today.

Dated _____, at San Francisco, California.